3 September 2026

Indonesia Market Color

Holding Up Against Rising Headwinds

Danamon

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Executive Summary

- **Global tightening risks are back, leaving Indonesia's external buffer increasingly exposed.** Sticky U.S. inflation, renewed Fed hike risks, and higher oil prices contrast with Indonesia's thinning trade surplus, where imports surged 27.0% YoY against 6.1% export growth in July.
- **Domestic inflation remains manageable, but external risks keep BI's tightening bias intact.** Headline inflation rose to 3.19% YoY on higher food prices, while El Niño and forest fires add supply-side risks. We expect BI to hold at 5.75% near term, with room to hike toward 6.25% by YE26 if FX and external pressures intensify.
- **Automotive demand is diverging between 4W normalization and resilient 2W growth.** We forecast 2H26 4W wholesales at 388,435 units (-9.0% YoY), while stronger commodity-linked incomes and potential EV incentives support 2W demand, with sales reaching 6.9mn units (+4.2% YoY) in 2027.

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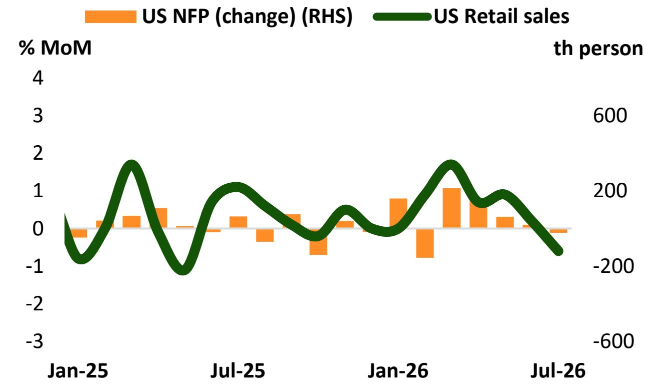
Global Markets

Sticky Inflation Puts Fed Hikes Back on the Table

Warsh raised the bar for declaring victory on inflation, while stopping short of committing to another hike. In his first Jackson Hole address as Fed Chair, Kevin Warsh argued that better summer inflation readings had yet to translate into a meaningful improvement in the underlying trend. PCE inflation remained elevated at 3.7% YoY and 4.1% on a six-month basis, while the U.S. economy continued to show resilience, with business capex rising rapidly amid the AI investment cycle. Warsh therefore stressed that price stability should remain the Fed's predominant focus, while avoiding commitment to a predetermined policy path.

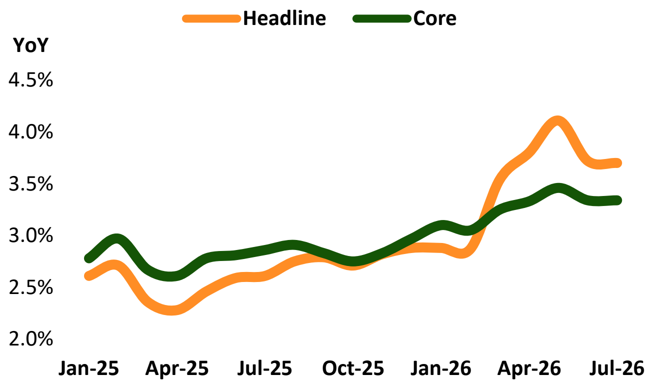
The Fed is increasingly caught between sticky inflation and a softer labor market. Developments entering September have reinforced the inflation side of the equation, with Brent rising further above USD95/bbl amid persistent Middle East supply risks. Yet labor conditions are becoming less convincing…*(cont.)*

Chart 1. Labor Markets & Consumption Softened



Source: Bloomberg

Chart 2. PCE Inflation Remained Elevated



Source: CEIC

July nonfarm payrolls unexpectedly fell by 23k, while May–June payroll gains were revised down by a combined 103k. The weakness extended into August, with ADP private payrolls rising by only 38k, below the 48k consensus. This leaves the Fed with an increasingly difficult trade-off (energy-driven inflation and still-sticky underlying price pressures arguing against premature easing), while further deterioration in employment could constrain the case for additional tightening.

Indonesia's External Balance

Trade Surplus Returned, but the External Buffer Remains Thin

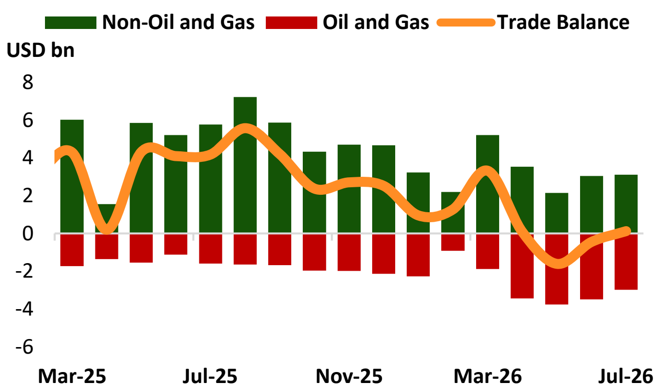
Indonesia returned to a modest trade surplus in Jul-26, although imports continued to outpace exports by a wide margin. The trade balance posted a USD122mn surplus, reversing a USD451mn deficit in Jun-26. Exports rose 6.1% YoY to USD26.2bn, supported by non-oil exports, while imports surged 27.0% YoY to USD26.1bn. The divergence is even more pronounced year-to-date, with imports rising 19.9% YoY against only 4.4% export growth in Jan–Jul, leaving the cumulative trade surplus at just USD3.70bn.

Lower energy imports provided some sequential relief, but the oil and gas deficit continued to absorb most of the non-oil trade buffer. Oil and gas imports declined 17.3% MoM in July, helping the headline balance return to surplus. Nevertheless, the oil and gas (O&G) deficit remained sizeable at USD2.98bn, almost fully offsetting the USD3.1bn non-oil and gas surplus. The same pattern is evident year-to-date. Indonesia accumulated a USD23bn non-oil surplus in Jan–Jul, but nearly USD19bn was absorbed by the oil and gas deficit.

The investment upcycle is also making Indonesia's growth increasingly import-intensive. Investment realization reached IDR1,010.6tn in 1H26, equivalent to 49.5% of the FY26 target, supported by basic metals, mining, downstreaming, transportation and telecommunications. Strong investment and industrial activity continue to pull in capital goods, machinery, raw materials and intermediate inputs. While these imports should ultimately expand productive capacity, the near-term effect is to absorb a larger share of Indonesia's export earnings.

A narrower trade buffer leaves the external balance increasingly reliant on capital inflows. The trade profile does not necessarily signal weaker economic fundamentals, rather, it reflects an investment-led growth cycle in which import demand is expanding faster than export receipts. However, with the current account deficit already widening sharply in 2Q26, a smaller goods surplus reduces the economy's cushion against external shocks. This should increase IDR sensitivity to higher UST yields, renewed USD strength and elevated oil prices.

Chart 3. Steady Non-O&G Surplus, Narrower O&G Deficit



Source: Statistics Indonesia

Chart 4. Investment-Induced Imports are Emerging

HS Code	Product Group	Import Value (USD bn)	Share of Total Imports (%)	YoY Growth (%)	Key Source Countries
HS 84	Machinery / Mechanical appliances & parts	20.07	17.42	+17.43	China (10.80, +16.42), Japan (1.34, -14.39)
HS 85	Electrical machinery / Equipment & parts	17.39	15.09	+19.63	China (10.53, +26.27)
HS 39	Plastics & articles thereof	6.16	5.35	+21.31	China (2.96, +59.98)

Source: Statistics Indonesia

Domestic Economy

Food Prices Revived Inflation, While Fuel Provided Relief

Inflation rebounded in Aug-26 as food prices reversed the previous month's correction. Headline inflation rose to 3.19% YoY from 2.88% in Jul-26, with CPI increasing 0.21% MoM following a 0.14% deflation previously. The sequential pickup was driven primarily by volatile food, which swung to 0.88% MoM inflation from a 1.68% deflation in July. As a result, volatile food inflation accelerated to 4.06% YoY from 2.52%, suggesting that August's higher headline print reflected more than an unfavorable base effect.

Food inflation returned as supply-side relief fades. Chicken meat, bird's eye chili and rice were the main contributors to volatile-food inflation in August, reversing part of the broad food-price correction seen in July. The shift remains manageable but suggests that the strong disinflationary impulse from improved agricultural supply is losing momentum. With El Niño-related dry conditions intensifying and forest fires spreading across several producing regions, weather-sensitive food prices are likely to become a more important source of inflation risk entering 4Q26.

Core inflation also firmed, although underlying demand pressures remain contained. Core inflation increased to 2.92% YoY from 2.76%, with monthly core inflation rising to 0.21% from 0.14%. However, the increase was partly driven by higher jewelry-gold prices alongside rising global gold prices, rather than purely stronger domestic demand. Meanwhile, administered prices provided an offset, falling 0.33% MoM as lower airfares and cuts to non-subsidized Pertamax and Pertamax Turbo prices helped contain transportation costs.

Inflation remains within BI's target, but the balance of risks is becoming less benign. Headline inflation remains comfortably within BI's 2.5±1% target range, while underlying inflation has yet to signal broad-based overheating. However, the combination of firmer food prices, intensifying El Niño conditions and renewed global oil-price pressures creates greater upside risk into 4Q26. Higher global energy prices could eventually reverse the recent fuel-price relief and feed into transportation and logistics costs, while prolonged dry weather and forest fires could disrupt food production and distribution. This reinforces the case for BI to maintain a stability-oriented policy stance, particularly as external inflation and FX risks are rising simultaneously.

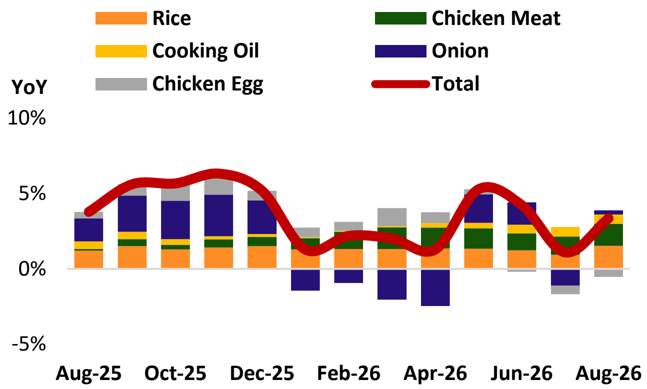
Forest Fires Re-Emerge as a Domestic Supply-Side Risk

Past episodes show that severe forest fires can generate material economic losses. The 2015 episode remains the clearest benchmark, with around 2.6mn hectares burned and World Bank-estimated losses of IDR221tn, equivalent to 1.9% of GDP. The economic impact was concentrated on agriculture, forestry, transportation and trade, with growth in some of the most affected provinces estimated to have been reduced by as much as 4.7ppts. A similar episode occurred in 2019, when around 620,000 hectares burned and economic damage and losses reached an estimated USD5.2bn, or around 0.5% of GDP. These episodes illustrate that prolonged forest fires can become a meaningful macroeconomic shock once disruption extends beyond the affected regions.

The 2026 fire season is intensifying, although the scale remains well below previous major episodes. Around 95,000 hectares had burned by July, while more than 9,000 hotspots were detected during August, concentrated particularly across Sumatra and Kalimantan. The government expects El Niño conditions to peak around September, leaving the fire season vulnerable to further deterioration as dry conditions persist. While the current episode remains far smaller than the 2015 and 2019 crises, the rapid increase in fire activity warrants monitoring has given the potential for disruption to intensify into the peak dry season.

The growth impact should remain contained unless fires escalate materially, but the risks are asymmetric. At the current scale, the national GDP impact is likely to remain limited relative to the major 2015 and 2019 episodes. However, a prolonged fire season could increasingly weigh on agricultural output, regional consumption, transportation and commodity exports, while higher logistics and food costs could add to inflation. Persistent disruption could eventually spill over into investment through weaker business activity and delayed project execution. The key risk is therefore not the damage recorded so far, but whether El Niño allows the current episode to develop into a broader and more persistent supply shock.

Chart 5. CEIC Food Index Showed Some Gains



Source: CEIC

Chart 6. 2026 Forest Fires Location and Its Sectoral Impact

Source: Google Maps as of Aug-24

Automotive Industry

Automotive Demand Rebounded on Commercial Vehicles and Electrification

Indonesia's automotive market strengthened markedly in Jul-26, extending the recovery seen through 7M26. Four-wheel (4W) wholesales reached 81,115 units in July, up 33.3% YoY and 4.5% MoM, bringing cumulative Jan–Jul sales to 517,742 units, around 18% above last year. Two-wheel (2W) domestic sales also remained resilient at 3.8mn units in 7M26, with July sales reaching 636,030 units. The improvement partly reflects a favorable base effect, but the breadth of the recovery (alongside new model launches and stronger electrified-vehicle offerings) suggests that automotive demand is gaining traction beyond statistical effects alone.

Commercial vehicles have emerged as an important driver of the 4W recovery. July's best-selling model was the Daihatsu Gran Max Pick Up, while the Suzuki Carry and Mitsubishi L300 also ranked among the month's top-selling vehicles. The strength of pickups and light commercial vehicles points to improving business-related demand alongside the recovery in passenger vehicles. Meanwhile, electrification continues to reshape the consumer segment, with BEV and hybrid model launches broadening product availability and supporting demand around the GIIAS period. The combination suggests that the current automotive upturn is increasingly broad-based across both household and business users.

Government-linked procurement could provide an additional tailwind to commercial vehicles, although execution remains key. Agrinas Pangan Nusantara has announced plans to procure 105,000 commercial vehicles for the Koperasi Desa/Kelurahan Merah Putih program, comprising pickups and light trucks supplied by Mahindra and Tata Motors. If implemented as planned, the procurement would represent a sizeable addition to commercial-vehicle demand and fixed-capital formation. However, the program is financed through bank lending, while fiscal expenditure provides indirect support through the earmarking of Village Development Funds for instalment. We therefore view it as potential upside to commercial-vehicle demand rather than the primary explanation for the 7M26 recovery.

A proposed 2W EV incentive could broaden the electrification cycle, but near-term absorption is likely to be gradual. The government is preparing an incentive of around IDR3mn per electric motorcycle, backed by a potential IDR3tn allocation that could theoretically cover up to 1mn units. The policy would mark a shift from the earlier emphasis on 4W electrification toward Indonesia's much larger motorcycle market. However, the implementing regulation had yet to be formally issued entering Sep-26, while domestic production capacity suggests actual take-up this year will be substantially below the maximum envelope. The near-term impact should therefore be viewed as an incremental demand catalyst rather than an immediate one-million-unit sales boost.

Fuel-subsidy reform could reinforce the transition over the medium term, although policy details remain unresolved. The government is considering restricting Pertalite access for households in deciles 9–10 as part of a broader effort to improve subsidy targeting, but implementation remains contingent on validating the underlying socioeconomic database. If implemented, higher effective mobility costs for higher-income households could strengthen incentives to shift toward more fuel-efficient and electric vehicles. Combined with EV incentives, the policy direction points toward a more coordinated electrification push, although the magnitude and timing of the demand response will ultimately depend on policy execution, charging infrastructure and vehicle affordability.

Outlook

Macroeconomy: External Risks Keep BI's Tightening Bias Intact

We maintain our view that BI's move to hike remains possible. Domestic inflation remains manageable within BI's target, but the external backdrop has become less benign as renewed Fed tightening risks, elevated UST yields, and higher oil prices coincide with Indonesia's thinner trade and current-account buffers. We expect BI to hold at 5.75% in the near term, with room to raise the BI-Rate toward 6.25% by end-2026 should renewed IDR depreciation, insufficient capital inflows, or stronger global rates intensify external pressures.

Non-rate measures should remain BI's first line of defense, keeping rate hikes as a backstop against more persistent external shocks. FX intervention, hedging incentives, and liquidity management should allow BI to contain currency pressures while limiting the growth cost of tighter monetary conditions. However, with Indonesia increasingly reliant on financial-account inflows to finance its external gap, the rate outlook remains asymmetric. Softer domestic activity alone is unlikely to trigger easing, while another leg higher in U.S. rates, oil prices, or USD strength could quickly reinforce the case for further tightening.

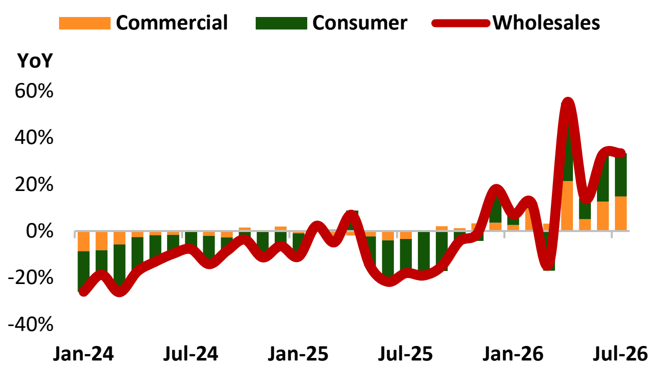
Automotive Industry: 4W Normalization Ahead, while 2W Demand Remains Resilient

We continue to expect 4W wholesales to soften in the months ahead, following a strong 7M26 recovery. Despite wholesales rising 18.3% YoY to 517,742 units in Jan–Jul, we expect momentum to moderate as three headwinds converge including fading base effects from 2H25, less aggressive BEV incentives, and the lagged impact of the 100bps BI-Rate increase on financing costs. With our macro view retaining the risk of further BI tightening, vehicle financing costs should remain elevated through year-end. We forecast 2H26 4W wholesales at 388,435 units (-9.0% YoY), with ICE vehicles potentially facing greater pressure if tighter Pertalite targeting raises effective fuel costs while EV incentives remain available.

2W demand should remain more resilient, supported by commodity-linked purchasing power and potential electrification incentives. CPO prices were 8.1% higher YoY as of 27 Aug, supporting incomes across palm oil-producing regions and underpinning our forecast for 2H26 2W sales of around 3.5mn units (+4.2% YoY). Looking into 2027, tight CPO supply (partly reflecting Indonesia's accelerating biodiesel program) should continue to support rural purchasing power. Meanwhile, the proposed IDR3mn per unit electric-motorcycle incentive, with a potential envelope of up to 1mn units, could provide an additional catalyst, particularly if enterprise and fleet purchases are accommodated. Subject to implementation and a broader participation mechanism, we expect 2027 2W sales to reach 6.9mn units (+4.2% YoY).

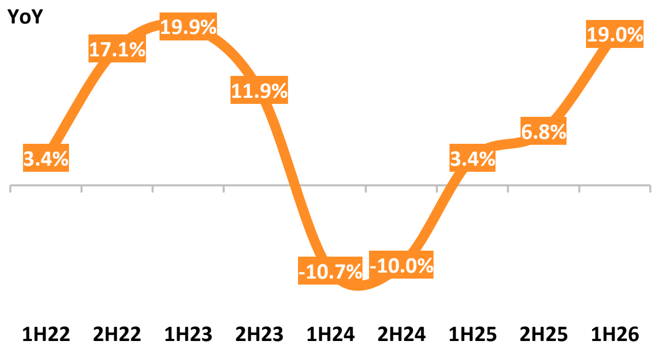
Pertalite reform should tighten, rather than eliminate, the fuel-consumption buffer. News headlines suggesting that the fuel quota will fall from 48mn to 20mn KL (-58.5% YoY) are not like-for-like. The 20mn KL figure refers to subsidized JBT fuels, while Pertalite is classified separately as compensated JBKP. On a comparable basis, the JBT quota rises slightly from 19.2mn KL in the 2026 Budget to 20.1mn KL in the 2027 Budget Draft. Meanwhile, even if Pertalite access is restricted for Decile 9–10 households, we estimate its quota could decline from around 28mn KL to roughly 20mn KL, rather than disappear altogether. This implies a tighter and better-targeted compensation scheme that should continue cushioning household mobility costs, while gradually strengthening incentives for higher-income consumers to shift toward more fuel-efficient and electric vehicles.

Chart 7. Commercial Vehicles is Driving Wholesales



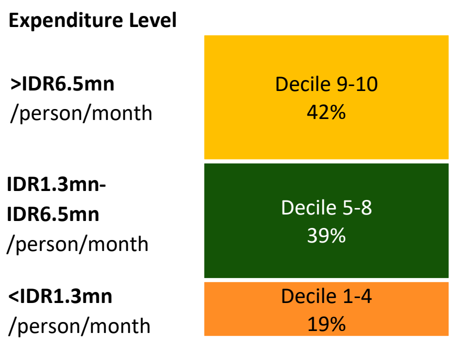
Source: CEIC, Bank Danamon Indonesia Calculation

Chart 8. Vehicles Investment Growth Exploded



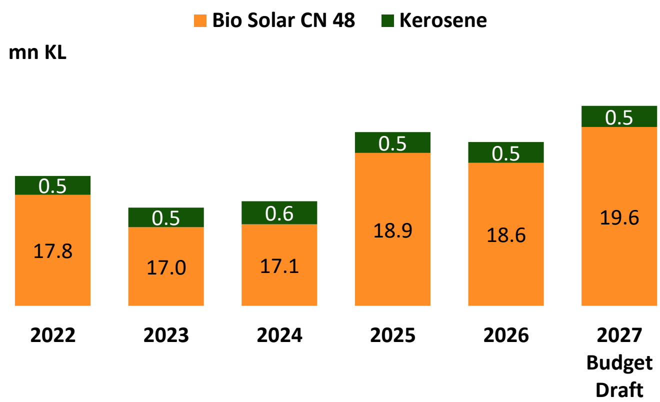
Source: CEIC, Bank Danamon Indonesia Calculation

Chart 9. Pertalite Consumption by Economic Group



Source: Compiled, Bank Danamon Indonesia Calculation

Chart 10. Subsidized Fuel Quota is Rising



Source: Ministry of Finance

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Indonesia's Selected Economic Indicators

	2023	2024	2025	2026E
National Accounts				
Real GDP (% y-o-y)	5.0	5.03	5.11	5.15
Domestic demand ex. inventory (% y-o-y)	4.6	4.94	4.99	5.08
Real Consumption: Private (% y-o-y)	4.9	4.9	4.98	5.13
Real Gross Fixed Capital Formation (% y-o-y)	4.4	4.61	5.09	5.18
GDP (USD bn) — nominal	1,371	1,440	1,445	1,681
GDP per capita (USD) — nominal	4,920	4,960	5,083	5,398
Open Unemployment Rate (%)	5.3	4.9	4.7	4.5
External Sector				
Exports (% y-o-y, BoP Basis)	-11.3	6.51	6.15	4.56
Imports (% y-o-y, BoP Basis)	-7.3	7.95	2.83	16.29
Trade balance (USD bn, BoP Basis)	46.4	31.04	41.05	9.75
Current account (% of GDP)*	-0.1	-0.3	-0.1	-1.5
Central government debt (% of GDP)	38.9	39.13	40.50	41.54
International Reserves –IRFCL (USD bn)	146.4	155.7	156.5	147.5
Reserve Cover (Months of imports & ext. debt)	6.5	6.5	6.3	5.6
Currency/USD (Year-end)	15,399	16,235	16,703	17,963
Currency/USD (Average)	15,244	15,920	16,482	17,635
USD/CNH (Year-end)	7.13	7.34	6.98	6.65
USD/CNH (Average)	7.09	7.21	7.19	6.70
Currency/CNH (Year-end)	2,161	2,199	2,391	2,701
Currency/CNH (Average)	2,150	2,199	2,292	2,632
Other				
BI Rate (% year end)	6.0	6.0	4.75	6.25
Consumer prices (% year end)	2.61	1.57	2.92	3.29
Fiscal balance (% of GDP; FY)	-1.65	-2.3	-2.92	-2.89
S&P's Rating – FCY	BBB	BBB	BBB	BBB

Source: CEIC, E= Danamon Estimates

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